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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

May 7, 1998

James D. Schlichting
Deputy Chief
Common Carrier Bureau
Federal Communications Commission
1919 M Street, NW, Rm. 500
Washington, DC 20554

EX PARTE


Re: Universal Service Report to Congress
CC Docket 96-45: Universal Service

Dear Mr. Schlichting:

MCI is providing the attached information to assist the Commission in preparing the report required by Congress to be submitted by May 8, 1998, addressing a number of issues concerning funding of the schools and libraries and rural health care program. The information provided includes the following:

1. An estimate of the expected reductions in interstate access charges anticipated on July 1, 1998.
2. The headroom available in interstate access services of the RBOCs, as of 1/1/98.
3. MCI's argument that impermissible implicit subsidies result when local exchange carriers pass their universal service contributions through to long-distance carriers in access charges without designating them as such.
4. MCI's argument on why the Commission should not mandate the flow-through of access charge reductions to customer classes.

Sincerely,


Mary L. Brown

Attachments

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ESTIMATED 7/1 ACCESS REDUCTIONS

Total Price Cap Revenue	23,066
Total Price Cap Revenue subject to g factor	10,418
Access Reductions	
GDPPi-X and g effects (GDPPi = 2.14%)	(1,024)
Reverse refund (Acc Inv, 800DB)	132
Reverse sharing	123
True-Up prior sharing	11
Current sharing/low end adj	(72)
Regulatory Fees	2
EDT	8
ITC	15
Bell Atlantic OBC reversal	17
US West X reversal	22
TRS	(4)
USF	(2)
Purchase/Sale of Exchanges	5
NANPA	0
Reg to NonReg	(0)
USF flow through	-
Total	(768)

As is illustrated in the table below, all the RBOCs are pricing Common Line and Traffic Sensitive access services as high as permissible ("at cap") under the Commission's price cap rules. Even for interstate transport services, the services for which CLEC competition has been developing for nearly ten years, all the RBOCs except Ameritech and Nevada Bell are pricing at cap.

RBOC Pricing of Access Services as of 1/1/98¹

RBOC	Trunking Basket	Traffic Sensitive Basket	Common Line Basket
Ameritech	5.7% Below Cap	At Cap	At Cap
Bell Atlantic	At Cap	At Cap	At Cap
BellSouth	At Cap	At Cap	At Cap
SBC	At Cap	At Cap	At Cap
Pacific Telesis	At Cap	At Cap	At Cap
Nevada Bell	6.1% Below Cap	At Cap	At Cap
US West	At Cap	At Cap	At Cap

¹ Source: ILEC Tariff Review Plan Filings, April 1, 1998.

B. Impermissible Implicit Subsidies Result When Local Carriers Pass Their Universal Service Contributions Through To Long-Distance Carriers in Access Charges Without Designating Them As Such.

The Order also creates a new form of implicit subsidy when local carriers recover their contributions to the new federal universal service fund through access charges, because the FCC has not required the amount of these pass-through contributions to be specifically and explicitly identified. The FCC's rules permit ILECs to recover their contributions by raising interstate access rates to long-distance companies. Id. ¶ 830.²²

Presently, the annual amount of such contributions passed through by ILECs is about \$850 million. See supra note 7. That number will grow when the new high-cost fund begins operation next year.

This recovery mechanism gives rise to a new implicit universal service subsidy insofar as the pass-through contributions are not identified as such. When an ILEC passes its direct universal service contributions through to long-distance carriers via access charges, no rule of the Commission

²² Specifically, the Commission's rules allow the ILECs to pass through their contributions into the Carrier Common Line charges, Primary Interexchange Carrier Charges, and trunking rates, but the ILECs are not required to identify the allocation of the contribution to each of the different access rates. See Access Charge Order ¶¶ 378-80.

requires the ILEC to disclose how much of each specific access charge is for recovery of its universal service contributions. As a result, long-distance carriers cannot determine how much of the access charges they pay is actually an indirect contribution to the federal universal service support mechanism, rendering this an implicit subsidy from the long-distance carrier (or its customers) to the recipients of the federal universal service support. This, in turn, prevents long-distance carriers from identifying these pass-through contributions with complete accuracy as universal service support on their bills to their own customers.

The absence of a regulation requiring the incumbents to identify these pass-through amounts when they bill long-distance companies for access violates section 254(e)'s requirement that all federal universal service support be "specific" and "explicit." See 47 U.S.C. § 254(e). To remedy this violation of the statute, the FCC must, at a minimum, mandate that every time an ILEC bills a long-distance company for access, it must identify the precise amount of each access charge that is a pass-through of its universal service contributions.²³

²³ MCI recently filed an emergency pleading with the FCC seeking this relief. See MCI Emergency Petition for

The Commission has consistently found that it can rely on market forces to ensure that access charge reductions are flowed through to long distance customers.¹ A year ago, in the 1997 Price Cap Review Order, the Commission observed that “there are no longer any dominant carriers in the market for interexchange services,”² and concluded that there was “nothing to indicate that market forces will not compel IXCs to flow through access charge reductions.”³ This conclusion has been borne out by IXCs’ rate reductions over the past year: MCI recently demonstrated to the Commission that its long distance rate reductions exceeded its access cost reductions by more than \$467 million.⁴

Robust competition in the long distance market maximizes consumer welfare by ensuring that all customer classes are served efficiently. As the Commission has found, “competitive markets are superior mechanisms for protecting consumers by ensuring that goods and services are provided to consumers in the most efficient manner possible and at prices that reflect the cost of production.”⁵ Over the past year, as shown in the March 2, 1998 MCI ex parte, the competitive market has translated access charge reductions into

¹In the Matter of Price Cap Performance Review for Local Exchange Carriers, First Report and Order, 10 FCC Rcd 8961, 8987 (“AT&T has passed on its savings from lower access charges in the form of optional calling plans and other discounts and promotions. We also have no reason to believe that AT&T’s long distance competitors have not been forced by competition to follow suit.”); In the Matter of Price Cap Performance Review, Fourth Report and Order, CC Docket No. 94-1, released May 21, 1997, at ¶185 (1997 Price Cap Review Order).

² 1997 Price Cap Review Order at ¶185.

³Id.

⁴Letter from Jonathan B. Sallet, Chief Policy Counsel, MCI, to William Kennard, Chairman, FCC, March 2, 1998, at 2 (MCI ex parte).

⁵In the Matter of Access Charge Reform, First Report and Order, CC Docket No. 96-262, released May 16, 1997, at ¶263 (Access Reform Order).

lower long distance rates benefiting both residential and business customers.⁶

Any Commission mandate governing the flow through of access charge reductions to customer classes would, by effectively reasserting Commission regulation of long distance prices, lead to a reduction in consumer welfare. It would impose compliance costs on IXCs and administrative costs on the Commission, and would interfere with a dynamic competitive market that has produced lower prices and innovative services for all customers. Over the past year, for example, residential customers have benefited from new offerings such as MCI's "5-Cent Sundays" and the introduction of simpler low-cost flat-rate calling plans. As the Commission recently stated, "competitive markets are far better than regulatory agencies at allocating resources and services efficiently for the maximum benefit of consumers."⁷

⁶MCI ex parte at 2.

⁷Access Reform Order at ¶42.